

LEGAL UPDATE

December 2011

By: *Michael T. Campoli*

SEC APPROVES “SEASONING” REQUIREMENTS FOR REVERSE MERGER COMPANIES

On November 9, 2011, the U.S. Securities and Exchange Commission (the “SEC”) approved new rules of the New York Stock Exchange (“NYSE”), the NYSE Amex (“Amex”) and the NASDAQ Stock Market (“NASDAQ”) that would impose “seasoning” requirements for private operating companies that have become reporting companies under the Securities Exchange Act of 1934, as amended, by combining with a public shell, whether through a reverse merger, exchange offer or otherwise (such a transaction, a “Reverse Merger”).

The exchanges proposed the new rules in response to the negative public attention that has been focused recently on companies – Most notably, China-based companies – that have engaged in Reverse Mergers. This attention includes allegations raised by the financial press, short sellers and others of widespread fraudulent behavior and accounting irregularities at such companies, and concerns regarding the motives and past behavior of promoters of these types of transactions.

The proposal by the exchanges, and the approval by the SEC, of the “seasoning” requirements follows similar actions by the Public Company Accounting Oversight Board (the “PCAOB”) and the SEC that have turned a spotlight on questionable practices at Reverse Merger companies. These regulatory actions include the issuance by the PCAOB of a “Staff Audit Practice Alert” in July 2010 and a “Staff Research Note” in March 2011 cautioning registered accounting firms to follow certain specified auditing practices when auditing Reverse Merger companies, enforcement actions that the SEC has recently initiated against a number of Reverse Merger companies, and the SEC’s release

in June 2011 of an Investor Bulletin in which it advised investors to proceed with caution when considering whether to invest in Reverse Merger companies due to the instances of fraud and other abuses uncovered at such companies.

In addition, as noted in the SEC’s press release announcing the approval of the new rules, the SEC and the exchanges have in recent months suspended or halted trading in more than 35 companies based overseas due to a lack of current and accurate information about such companies and their finances, many of which became public via Reverse Merger.

SUMMARY OF THE “SEASONING” REQUIREMENTS

The new rules provide that a company that becomes public via Reverse Merger shall be eligible to list its securities on the NYSE, NASDAQ or the NYSE Amex only if the combined entity has:

- traded for at least one year in the U.S. over-the-counter market, on another national securities exchange, or on a foreign exchange, following the filing of all required information about the Reverse Merger (typically a “super” Form 8-K), including audited financial statements for the combined entity;
- timely filed all required reports since the time of the Reverse Merger, including at least one annual report, which annual report must contain audited financial statements for a full fiscal year following the filing of all required information about the Reverse Merger;¹ and

¹ As a result of this requirement, if a company that has a fiscal year ending on December 31 files a “super” Form

- maintained the requisite minimum stock price (\$4.00 in the case of the NYSE and NASDAQ, and \$3.00 for NYSE Amex) for a “sustained period,” and also for at least 30 of the 60 trading days immediately preceding both the submission of the initial listing application and the approval thereof by the relevant exchange.

These new “seasoning” requirements are in addition to the requirements that are generally applicable to companies seeking to list their securities on the national securities exchanges.

A Reverse Merger company would be exempt from the “seasoning” requirements if it is listing in connection with a firm commitment underwritten public offering with gross proceeds of at least \$40 million, or if the Reverse Merger occurred so long ago that at least four annual reports on Form 10-K with audited financial information have been filed with the SEC following the one-year trading period.

PURPOSE OF THE “SEASONING” REQUIREMENTS

The exchanges proposed, and the SEC approved, the new listing requirements in anticipation that they will result in significant benefits that protect investors in Reverse Merger companies. In particular, the “seasoning” requirements are designed to allow the regulatory agencies more time to view trading patterns and uncover potentially manipulative trading, to result in a more bona fide shareholder base and to assure that the bid price requirement was not satisfied through manipulation. Also, the requirement that companies file additional reports with the SEC before listing their securities on a national exchange is intended to improve the reliability and integrity of the reported financial results due to the involvement that the company’s auditors and audit committee will have in the preparation and review of those reports, and to provide additional time so that the company can

8-K with respect to a Reverse Merger in January 2012, such company would not be eligible to apply to a national securities exchange until after it has filed its Annual Report on Form 10-K for the fiscal year ending December 31, 2013 – presumably sometime in March 2014.

implement, evaluate and correct its internal controls.

CONCLUSION

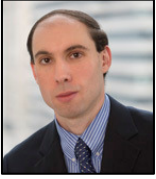
It remains to be seen what overall impact the new “seasoning” requirements will have on the willingness and ability of private companies to become publicly reporting. To the extent that a private company is willing to expend the time and resources to become public via a traditional initial public offering, or is capable of effecting a Reverse Merger simultaneously with a substantial underwritten public offering, in each of which case it would not be subject to the “seasoning” requirements, it is now more advantageous for it to do so. For a private company that is not so fortunate, the new requirements may increase the attractiveness of having its securities quoted on an alternative platform that promises liquidity and transparency to investors but that does not have “seasoning” requirements, such as the OTCQX, for a period of time after effecting a Reverse Merger before, or perhaps in lieu of, uplisting to a senior exchange.

If you have any questions or would like any further information about the new “seasoning” requirements or how Pryor Cashman can serve your legal needs, please contact the author of this Legal Update or the Pryor Cashman attorney with whom you work.

The foregoing is merely a discussion of the SEC’s approval of “seasoning” requirements for reverse merger companies. If you would like to learn more about this topic or how Pryor Cashman LLP can serve your legal needs, please contact Michael T. Campoli at 212-326-0468, mcampoli@pryorcashman.com.

Copyright © 2011 by Pryor Cashman LLP. This Legal Update is provided for informational purposes only and does not constitute legal advice or the creation of an attorney-client relationship. While all efforts have been made to ensure the accuracy of the contents, Pryor Cashman LLP does not guarantee such accuracy and cannot be held responsible for any errors in or reliance upon this information. This material may constitute attorney advertising. Prior results do not guarantee a similar outcome.

ABOUT THE AUTHOR



MICHAEL T. CAMPOLI

Of Counsel

Direct Tel: 212-326-0468

Direct Fax: 212-798-6361

mcampoli@pryorcashman.com

Michael Campoli devotes his practice to counseling public and private companies on a broad range of corporate matters, including securities law compliance, corporate formation and governance, mergers and acquisitions, public and private debt and equity financing transactions, and limited liability company and partnership counseling.

Mr. Campoli's work at Pryor Cashman has included the representation of:

- Marina Biotech, Inc. (NASDAQ: MRNA) as outside general counsel in connection with its equity and debt financings, M&A initiatives and Securities Exchange Act reporting requirements
- Javelin Pharmaceuticals, Inc. (NYSE Amex: JAV) as outside general counsel in connection with its equity financings and Securities Exchange Act reporting requirements
- Henry Schein, Inc. (NASDAQ: HSIC) in connection with the acquisition of various private companies in the medical equipment and software industries
- Cowen and Company, LLC, Rodman & Renshaw, LLC and Global Hunter Securities, LLC in connection with various underwritten public offerings for domestic and foreign issuers
- Briad Restaurant Group in its prevailing tender offer for Main Street Restaurant Group, Inc., the largest T.G.I. Friday's franchisee
- The Kushner Companies in connection with its acquisition of the office building located at 666 Fifth Avenue, New York, New York
- A private telecommunications company in connection with the issuance of secured notes to the Rural Utilities Service of the U.S. Department of Agriculture and the concurrent placement of preferred stock to venture capital investors